

ADVISORY COMMITTEE: APARTMENT RENT ORDINANCE

REGULAR MEETING ACTION MINUTES

OCTOBER 17, 2015

MEMBERS PRESENT: Matthew Carney
Joshua Howard – arrived at 11:24
John Hyjer
Amiee Inglis
Melissa Morris
Michael Pierce
Elisha St. Laurent
Tom Scott

MEMBERS ABSENT: Gustavo Gonzalez
Roberta Moore
Elizabeth Neely
Eloise Rosenblatt

STAFF:	Jacky Morales-Ferrand	Housing Department
	Wayne Chen	Housing Department
	Maria Haase	Housing Department
	Ann Grabowski	Housing Department
	Shawn Spano	Contracted Facilitator

(a) Call to Order/Orders of the Day—Shawn Spano opened the meeting at 10:14am.

(b) Introductions— Mr. Spano introduced himself, committee members introduced themselves, and members of the Housing Department introduced themselves.

(c) Approval of the September 30, 2015 Action Minutes

Ms. Morris asked for clarification on whether the committee was allowed to vote on the minutes as a non-decision making body.

Ms. Grabowski answered that the committee was not required to approve the minutes, but because the meeting minutes were part of the public record, staff wanted the committee to have an opportunity to provide any necessary clarifications.

The approval of the 9/30 minutes was deferred.

(c) Unfinished business from October 14th meeting, if any (Housing Staff, Facilitator)

There was no unfinished business.

(d) Discussion and possible action of unfinished business from October 14th meeting (Housing Staff, Facilitator)

Mr. Chen presented information on alternative standards to the annual allowable increase.

DRAFT

Mr. Scott stated his objection to the focus questions as presented because: the cap was not intended to be an index and comparing our policy to other cities policies because both are bad public policies.

Ms. Morris responded that the ARO allows for the pass through of specific costs. Mr. Carney recited the section of the Ordinance. Ms. Morris continued that the annual allowable increase is similar to an index because there are other mechanisms to pass through indexed costs for maintenance.

Ms. Inglis shared that from past meetings information was shared that there had not been any operations and maintenance pass throughs, only debt service, so owners in San Jose were likely using the 8% annual allowable increase to absorb costs that were eligible to be passed on outside of the allowable.

Mr. Pierce shared that markets are cyclical and landlords can't receive/charge more rent than the market allows. CPI punished landlords severely. When the market drops, rents can't reset. Regardless of the annual allowable rate, a landlord can't charge rents at a rate that people aren't willing to pay. Mortgages aren't indexed – most are fixed rate.

Ms. Morris stated that she was glad to hear about fixed rate mortgages. As a homeowner her homeownership costs are relatively predictable and stable. Homeownership is out of reach for many people. Those people aren't choosing to rent over buying a home – they can't afford a home. People choose to get into the real estate business, but they rarely choose to rent. The purpose of the ARO is to provide stability to those who cannot afford to buy a home.

Mr. Pierce responded that renters have a choice on where to rent. Market forces need to apply to all parties. This policy needs to be fair to all parties.

Mr. Chen continued the presentation.

Focus Question: does the annual allowable increase meet the public policy purpose as stated in the ARO? [prevention of excessive increases, alleviation of undue hardship on tenants, assurance of a fair and reasonable return]

Ms. Morris responded that because the annual allowable increase is so high, the ARO does not meet the first two public policy goals.

Mr. Scott said that there is no practical way for the City to fully understand the business practices of thousands of property owners operating ARO housing to properly determine the fair rate of return. A cap is not an index.

Ms. Morris said that regarding fair rate of return – there is a difference between fair rate of return and unfettered pursuit of profit. The ARO has provisions to pass through costs and seek an additional amount of an increase to ensure a fair rate of return. This provision allows landlords their constitutional right to a fair rate of return and will be a provision in a new ordinance.

Ms. St. Laurant said that she doesn't have another income like landlords do. Has to make significant choices between basic needs on a regular income. Believes that a 2% cap on the annual allowable increase would be ideal.

DRAFT

Mr. Pierce said that while discussions of pass through provisions can continue, it's important to remember that the hearing officer has the right to determine what is reasonable and reduce the amount passed-on to the tenants, even if the owner was otherwise entitled to recoup more of their costs.

Ms. Inglis doesn't believe that the ARO meets the tenant-focused public policy goals. The 8% was set based of inflation in 1979. Because there haven't been operations and maintenance petitions, it seems that the 8% provides a fair rate of return. The ARO is not a rent ceiling.

Mr. Pierce said that the entire basket of housing costs are up – not just rents. The escalating cost of home sales puts pressure on the rental market. Is the City going to cap the price of single family homes? We need to think about who is going to pay for the rental subsidy that we're looking for.

Mr. Scott asked if an increase to the 8% cap in certain circumstances should be considered, perhaps in circumstances when rents have been flat for years, but the building suddenly needs a major capital work.

Ms. Inglis offered that in other markets there are regulations against price fixing and price gouging. The ARO provides that regulation for the rental market.

Ms. Morris said that there is a provision in the current ARO to bank rental increases at 21% over 24 months. Wants to be clear that rent control does not “cap” rents because vacancy decontrol exists.

Mr. Chen continued the presentation.

Focus Question: Does the fixed percentage increase align with the shared principles of certainty, predictability and fairness & Pros and Cons

Mr. Scott said that because other cities have shifted their annual increase doesn't mean San Jose should, especially without researching the impacts on the rental market in those cities. Considers tracking CPI as bad public policy.

Mr. Hyjer said that when looking at other cities represented on the graph, each of the cities on the low end on the annual increase have the largest problem with housing because when you reduce the annual allowable increase the housing stock declines. People choose to leave the housing market because it's not worth it. This is a societal problem – why are housing providers being burdened by this issue. The City should create a fund to provide a subsidy through a means test. People will stay in units there will be little vacancy.

Ms. Inglis doesn't agree that rent stabilization is a failed policy. Rent control exists in cities because rents were out of control, AROs were not the cause of rent shortages. Must consider whether the policy has worked to prevent displacement. Believes that existing 8% allowable provides certainty and predictability, but doesn't believe that it provides fairness.

Ms. Morris responded to Mr. Hyjer's comments about subsidy programs. Subsidies are one part of meeting the affordable housing needs of a community, as rent control is. Neither is a panacea. Empirical studies show that rent control has a net neutral effect on housing prices – but it does prevent displacement. Does not agree that the correlation between SF's tight rental market and rent

DRAFT

control is causation. Without rent control, low income tenants probably would've been gone long ago. Rent control isn't the only policy that will solve our affordable housing shortage. Fixed percentage provides predictability and certainty but does not track the economy.

Mr. Pierce said if the goal is fairness, perhaps tenants should be forced to stay in units when the market goes soft instead of allowing them to move where the jobs are. Supply is an important factor. Housing supply is not fluid and the City has a lot of policies that restrict housing supply. The housing problem is not the fault of property owners.

Mr. Scott commented that when you clamp down on the annual increase cap, you see other changes to the policy like San Francisco.

Mr. Chen continued the presentation to an inflation-based index.

Focus question: Does an inflationary index align with the principals of predictability certainty and fairness?

Mr. Pierce asked why 1978-2007 was selected.

Mr. Chen answered that 1978 was selected because that's when the Ordinance was created.

Ms. Morris asked if Berkeley and San Francisco had a floor and a ceiling.

Mr. Pierce asked if data on housing costs during that period is available.

Mr. Chen answered that the data can be provided.

Ms. Inglis said that rent control is often litigated. San Francisco's index of 60% of CPI has been upheld by the courts.

Mr. Scott offered that the price of housing has skyrocketed since 1978.

Ms. Morris believes that CPI offers an element of fairness, though the fluctuation does limit the certainty or predictability.

Mr. Scott said that you can write anything into an ordinance to make it legal but it doesn't make it responsive to the market. Our economy fluctuates in big cycles. The problem with using an index is that it locks in the downside but doesn't respond to the upside.

Mr. Carney said that the fixed increase is a little daunting. Even as a teacher with a wage schedule, his income doesn't meet the 8% schedule. If buying power matched annual rent increase, he would be able to invest in a rental property. Even with a lower increase, he wouldn't choose to stay in an apartment, he would choose to buy a home.

Mr. Pierce said that markets are cyclical. People are mobile but buildings are not. Family member moved to Portland because housing costs were lower there. The relative change of costs to occupancy make CPI very difficult to recoup costs.

Mr. Howard said that he needs to understand the magnitude of the problem that we're trying to solve before he can respond to an alternative standard. Would like to know how many petitions were denied

DRAFT

because they were allowed by rite. Does not know any other entity that sets a required rate of return. If owners feel that they aren't getting a fair rate of return they will flip the unit. No other city fees are tracking with inflation. Everything is tracking higher than inflation. Model doesn't meet any of the shared principles.

Mr. Carney said that with the fluctuation of the economy, lower income folks don't see the benefit of a higher income or growth in wages. Appreciates that landlords want to capitalize on a higher market. People can't just get up and leave the area. Some can't afford to move to another city.

Ms. Inglis said that if the annual increase is tied to inflation there should be a petition process to recoup O&M costs, which already exists under the program. The housing crisis is happening nationally, so even when people move, housing costs are going to be a problem.

Mr. Pierce said that the reason that housing costs are increasing because of public policy. There are tons of jobs, but the City isn't allowing housing production to occur at a rate close to the job growth. The supply issue is the one we should be focused on. [Provided modeling example]

Ms. Morris said that as the "burdens" on landlords are discussed, the benefits provided through public policy and government influence like good schools, parks, community infrastructure, which drives up rents because properties become more valuable should also be discussed. This is important to remember when discussing fairness. As a city we've said we believe in diversity and preserving affordable housing, which is to say that we need to work to prevent displacement.

Mr. Chen continued the presentation to the operating cost standard.

Focus questions: does an operating cost model provide predictability, fairness and certainty?

Mr. Howard doesn't believe that this model is very difficult to administer and would create a significant amount of work, while reducing predictability. Would not achieve any objectives.

Mr. Scott said that he's not sure exactly what a fair return is, but without City Hall underwriting the downside of the economy, landlords aren't going to sign up for this.

Mr. Carney asked if staff was suggesting any specific model at this point.

Ms. Inglis said that this model appears to be a significant amount of work and that there should be a separate pass-through for operations and maintenance.

Mr. Hyjer had questions about the data. In the Bay Area operating costs makeup about 37% of total costs and smaller operators likely have higher costs. There is no consistency in the change in utility costs except that they never go down.

Mr. Pierce offered that an additional standard to look at should be means testing of incomes for renters.

Mr. Howard said that in New York City when rents hit a higher level and the tenant's income meets a certain level, then unit is removed from rent control or the annual increase moves above the allowable increase.

DRAFT

Ms. Morris said that if we're going to means test we would need to place a restriction on landlords being able to increase rents beyond 30% of a tenants income. This increases unfairness between the tenant and the landlord. This is very sensitive information.

Mr. Hyjer said that we need to remember that truly affordable housing is affordable in perpetuity. The City has been lacking in providing enough incentive to developers to provide that kind of housing.

Ms. Morris said that if we wanted to frame what we are doing as providing a subsidy, we need to talk about all of the restrictions that come with subsidy programs. Rent control is not a subsidy program.

Mr. Pierce said that as an owner of property he can choose to participate in the housing authority's programs and opt-in to those limits or choose to accept subsidies to comply with an affordability restriction.

Ms. Inglis said that rent control is an anti-displacement mechanism not a subsidy.

Mr. Carney asked if the unit would remain decontrolled after a means-tested tenant vacated the unit.

Mr. Pierce said that means testing allows the free market to set the rental price. Current restrictions depress the rent amount.

Mr. Chen continued the presentation to multi-year increases/banking.

Focus question: does banking align with certainty, predictability and fairness?

Mr. Pierce says that banking is fair-er.

Mr. Carney said that the current 21% is unfair to tenants.

Mr. Scott said that banking should be as lenient as possible. Has rarely seen the 21% used except in cases when rents have been flat.

Mr. Pierce said that residents of units during a soft market is also "banking" because rents fall.

Mr. Carney said that not all tenants are banking in any circumstance. Some tenants are paying up and over 50% of their income in rent.

Mr. Howard said that markets are cyclical. Property owners have to respond to the market and banking allows for the quick recovery of market-based reductions in rent.

Mr. Carney said that he would like to see data on declines in rent. Not sure that households are so mobile to up and move based on rent prices.

Ms. Morris said that she has not experienced rent decreases for in-place tenants. Regarding banking, it does not allow much predictability for tenants. If it's to be considered, it does need to be capped.

DRAFT

Mr. Hyjer said that rent decreases do happen. Landlords lower their rents to keep people in their homes to prevent vacancy. The housing market is supply and demand based.

41 members of the public provided public comment.

(e) Open Forum

23 members of the public provided public comment.

(f) Adjourn Facilitator Shawn Spano adjourned the meeting at 1:58 pm.